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*October 2003*

# Testamentary Trusts in a Nutshell

### Introduction

In response to many requests from financial advisers, we have decided it's time to cut through the mystique of testamentary trusts and go back to basics....

### Starting at the beginning - what is a trust?

Imagine that a school teacher goes to the milk bar and purchases six bags of lollies for her students. Back in the classroom she opens the bags and places all of the lollies in a jar and locks it, keeping the key. The teacher is the legal owner of the lollies & intends to give them to her students over time as and when she decides that they "deserve" to receive them. She decides which of the students in the classroom will receive what type, how many and when. She has complete discretion in relation to that decision.

In this example, the lollies are the trust fund. The school teacher is the trustee. The students are the beneficiaries and because the teacher has complete discretion as to which student(s) are to receive which lollies, the trust is a discretionary trust.

The relationship goes further. The school principal can remove the teacher at any time and replace her with another teacher who then becomes the person who controls the lolly jar. The second teacher becomes the trustee. The school principal has the legal ability to do this because the "rules" enable them to do so - they can even become the teacher thereby taking control of the lollies.

The school principal effectively controls the trust and is known as the appointor or sometimes as the "principal". This is the most important position because they retain ultimate control.

So, the trustee (teacher) is the legal owner of the trust fund (lollies) for the benefit of the beneficiaries (classroom of students) and the appointor (school principal) can remove the trustee at any time.

### And in legal speak ...

A trust is a legal relationship between parties with the relationship revolving around the trust fund. There is always a trustee and at least one (but usually more) beneficiary(s).

The trust fund is at the core of the trust relationship. The trust fund can include anything which can be owned including money, real estate, shares, motor vehicles, boats, contractual rights, intellectual property rights, goodwill of a business, plant and equipment, debtors etc.

The trustee is the legal owner and the beneficiaries are the beneficial owners. The trustee has complete control over the trust fund subject to legal restrictions and the rules governing the particular relationship, such as a Will or a trust deed.

The appointor or principal is the person who can replace the trustee at any time for any reason. They can also appoint themselves as trustee.

### And now for testamentary trusts.....

.... A testamentary trust is a trust (usually a discretionary trust) which can only be established by a Comprehensive Will containing the appropriate provisions. Most wills are standard wills (whether created by a lawyer or not) and do not contain provisions for a testamentary trust.

A Comprehensive Will containing testamentary trust provisions works this way:

John decides to give all of his estate to his wife Anne if she survives him and if not, then their children equally. He wants to provide the safest and most tax effective method of delivering his inheritance to his family so he decides to have a Comprehensive Will. John dies leaving an estate of $500,000 and Anne survives John.

The Comprehensive Will enables Anne to take the $500,000 through a testamentary trust which she controls (she is the appointor) rather then owning the money in her own name. She has the choice of whether to take the inheritance through the testamentary trust or to take it in her own name. Because the Comprehensive Will gives her the choice she decides (for reasons of asset protection, maintaining control of the inheritance and tax minimisation) to take the inheritance through the testamentary trust.

So, the $500,000 is the trust fund, Anne is the appointor and will decide who the trustee will be (probably herself) and the beneficiaries are a range of people being the persons who make up the family associated with Anne. They will certainly include her children but may or may not include their spouses.

## And the benefits are......

### Asset protection

If Anne ever became bankrupt the inheritance would not be available to her bankruptcy trustee and would be protected from her creditors. This may be useful if her next husband causes her financial grief!

### Tax minimisation

If the $500,000 is invested and earns say $30,000 in the first year the income can be distributed to her children who will be taxed as if they were adults without penalty. The children can take advantage of the marginal tax rates thereby saving a lot of tax.

### Control by blood relatives

If Anne remarries she can more easily ensure the testamentary money remains separate from her husband. The trustee of the testamentary trust does not have the ability to pay Anne's husband any money from the trust fund because John restricted the beneficiaries to his 'bloodline' thereby giving greater control over the trust fund to Anne.

## Checklist: do I have clients who need a testamentary trust?

**If your clients satisfy any one of the following criteria they probably need a Comprehensive Will with a Testamentary Trust…**

1. Do they have assets worth more than $300,000?
2. Do they have children from a prior relationship?
3. Does the client want to minimise the tax that their beneficiaries might have to pay?
4. Does the client have children who may run their own business or have their assets exposed to bankruptcy?